No. 17-1077

In the Supreme Court of the United States

FRANCIS V. LORENZO,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR PETITIONER

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QUESTION PRESENTED

The antifraud provisions of the federal securities laws prohibit two well-defined categories of misconduct. One category is the use of *fraudulent statements* in connection with the offer and sale of securities. The other category is employing *fraudulent schemes* in connection with the offer and sale of securities. In *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011), this Court considered the elements of a fraudulent statement claim and held that only the "maker" of a fraudulent statement may be held liable for that misstatement under Section 10b(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5(b).

The question presented is whether the D.C. Circuit erred in concluding a misstatement claim that does not meet the elements set forth in *Janus* can be repackaged and pursued as a fraudulent scheme claim under Section 10(b) of the Exchange Act, Rules 10b-5(a) and (c) and Section 17(a)(1) of the Securities Act.

STATEMENT PURSUANT TO RULE 26.9

Petitioner's corporate disclosure statement was set forth in the Petition for a Writ of Certiorari. There are no amendments to that statement.

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BRIEF FOR PETITIONER

Petitioner Francis Lorenzo respectfully submits that the judgment of the D.C. Circuit upholding the SEC's finding that Petitioner violated Section 10(b) of the Exchange Act, Rules 10b-5(a) and (c) and Section 17(a)(1) of the Securities Act should be reversed.

OPINIONS BELOW

The D.C. Circuit's opinion and Judge Kavanaugh's dissent (Pet. App. 1-50) are reported at 872 F.3d 578 (D.C. Cir. 2017). The opinion and order of the Securities and Exchange Commission ("SEC") (Pet. App. 51-95) are available at Exchange Act Release No. 74836, 111 S.E.C. Docket 1761 (2015 WL 1927763). The relevant initial decision of the SEC administrative law judge (Pet. App. 96-121) is available at 107 S.E.C. Docket 5934 (SEC Initial Decision Release No. 544, 2013 WL 6858820).

JURISDICTION

The judgment of the D.C. Circuit was entered on September 15, 2017. (Pet. App. 1-50). On December 19, 2017, Chief Justice Roberts granted the Petitioner's request to extend the time to file a writ of certiorari to and including January 26, 2018. The petition was filed on January 26, 2018 and granted on June 18, 2018. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

Section 17(a)(1) of the Securities Act of 1933, 15 U.S.C. § 77q(a)

Fraudulent interstate transactions

(a) USE OF INTERSTATE COMMERCE FOR PURPOSE OF FRAUD OR DECEIT It shall be unlawful for any person in the offer or sale of any securities (including security-based swaps) or any security-based swap agreement (as defined in section 78c(a)(78) [1] of this title) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j

Manipulative and deceptive devices
It shall be unlawful for any person, directly or indirectly, by the use of any means or

instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SEC Rule 10b-5, 17 CFR 240.10b-5

Employment of manipulative and deceptive devices.
It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

The antifraud provisions of the federal securities laws prohibit two well-defined categories of misconduct in connection with the offer and sale of securities. One category is the use of fraudulent statements in connection with the offer and sale of securities; the other category is employing fraudulent schemes. With regard to fraudulent statements, Section 17(a)(2) of the Securities Act of 1933 (the "Securities Act") establishes liability for misstatements and proscribes obtaining money or property by means of any untrue statement or omission of a material fact. Likewise, Section 10(b) of the Securities and Exchange Act of 1934 (the "Exchange Act") and SEC Rule 10b-5(b) thereunder prohibit making any "untrue statement of a material fact. . ."

With regard to fraudulent schemes, Section 17(a)(1) of the Securities Act prohibits anyone from employing any "device, scheme, or artifice to defraud" in the offer or sale of securities. Likewise, Section 10(b) of the Exchange Act and SEC Rule 10b-5(a) prohibit anyone from employing "any device, scheme, or artifice to defraud" in connection with the purchase or sale of securities and Rule 10b-5(c) prohibits anyone from engaging in "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. . ." in connection with the purchase or sale of securities. Claims brought under Rules 10b-5(a) and (c) are generally referred to as "scheme liability" claims. *See, e.g., In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 643 n. 29 (3d Cir. 2011), *abrogated on other*

grounds by Amgen Inc. v. Connecticut Retirement Plans and Trust Funds, 568 U.S. 455 (2013)("We refer to claims under Rule 10b-5(a) and (c) as 'scheme liability claims', because they make deceptive conduct actionable, as opposed to Rule 10b-5(b), which relates to deceptive statements.")

Courts have described Section 17(a)'s proscriptions as "substantially identical" to those in Rule 10b-5. *See, e.g., Landry v. All Am. Assurance Co.*, 688 F.2d 381, 386 (5th Cir. 1982); *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999) ("Essentially the same elements are required under Section 17(a)(1)-(3) in connection with the offer or sale of a security" as under Rule 10b-5, "though no showing of scienter is required . . . under [Section 17](a)(2) or (a)(3)."); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996) ("With respect to § 17(a)(1), essentially the same elements [as in a Rule 10b–5 claim] must be established in connection with the offer or sale of a security.").

Here, Petitioner, who was the head of investment banking at a stock brokerage firm, sent an email to two investors that was written by his boss. The email concerned an upcoming bond offering by Waste2Energy Holdings Inc., one of the firm's corporate clients. The email turned out to have three misstatements in it concerning the features of the bond offering. The D.C. Circuit held that Petitioner did not violate Rule 10b-5(b) because he was not the maker of the statements in the email because his boss retained 'ultimate authority' over the statements under the holding in *Janus Capital*, 564 U.S. 135, 142 (2011). (Pet. App. 2). However, the D.C. Circuit held that even though

Petitioner was not the maker of the misstatements he could still be held liable as a primary violator of Rule 10b-5(a) and (c) and Section 17(a)(1) for the same misstatements under a theory of scheme liability because Petitioner helped produce and distribute the two emails.

The D.C. Circuit erred in its holding that Petitioner's ministerial acts in helping produce and send the two emails may constitute the basis for imposing scheme liability. Claims for fraudulent statements are distinct from claims for fraudulent schemes. *Desai v. Deutsche Bank Sec., Ltd.*, 573 F.3d 931, 939 (9th Cir. 2009). This Court in *Janus* carefully set forth the elements that a plaintiff must establish to prove a fraudulent statement claim under Section 10(b) of the Exchange Act and Rule 10b-5(b). The D.C. Circuit's decision below allows the SEC and private plaintiffs to sidestep *Janus*'s carefully drawn elements of fraudulent statement claims merely by relabeling the claims -- with nothing more -- as fraudulent scheme claims.

The D.C. Circuit's decision imposing primary liability on Petitioner for ministerial conduct that was neither deceptive nor manipulative is contrary to the text of Section 10(b) and this Court's holding in *Central Bank* that a "plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of §10(b)") *Central Bank of Denver, N. A. v. First Interstate Bank of Denver, N. A.*, 511 U.S. 164, 173 (1994) The SEC's claims against Petitioner for fraudulent scheme liability based on his nondeceptive conduct extend Rules 10b-5(a) and (c) beyond the scope of Section 10(b). Lorenzo's nondeceptive ministerial conduct also falls outside of Section 17(a)(1)'s

proscriptions against employing "any device, scheme. or artifice to defraud."

The D.C. Circuit's decision also erases the important distinction between primary and secondary violations of the securities laws and opens up large numbers of defendants who are secondary actors at best to claims for primary violations of the securities laws. Permitting primary scheme liability to be imposed on Lorenzo based on statements he did not make would significantly broaden the categories of defendants who can be targeted for primary liability in both SEC actions and private actions. All of these newly at-risk defendants would be secondary players at best. To permit scheme liability "to attach to individuals who did no more than facilitate preparation of material misrepresentations or omissions actually communicated by others ... would swallow the bright-line test between primary and secondary liability." *SEC v. PIMCO Advisors Fund Management LLC*, 341 F. Supp. 2d 454, 467 (S.D.N.Y. 2004); *see also SEC v. Kelly*, 817 F. Supp. 2d 340, 343-44 (S.D.N.Y. 2011).

Here, Petitioner was at most a secondary actor who assisted his boss Gregg Lorenzo (no relation to Petitioner Francis Lorenzo) in sending the two emails in question. Congress has constructed a well thought out statutory scheme whereby the SEC may bring claims for aiding and abetting under Section 20(e) of the Exchange Act (15 U.S. Code § 78t(e)) and the D.C. Circuit's decision upsets this balance. In addition, the D.C. Circuit's decision opens up large numbers of defendants to claims for primary violations of the federal security laws – claims that would otherwise be barred in private litigation under the holding of *Central*

Bank, which eliminated aiding and abetting liability in private securities fraud litigation and in SEC enforcement actions. (*Stoneridge Investment Partners, LLC*, 552 U.S. 148, 167-68, 173 n.7 (2008) (Stevens, J., dissenting); *In the Matter of John P. Flannery and James D. Hopkins*, SEC Release No. 3981, 2014 WL 7145625, at *15, n. 73, *vacated on other grounds*, *Flannery v. SEC*, 810 F.3d 1 (1st Cir. 2012) (acknowledging that *Central Bank* requires the SEC to distinguish between primary and secondary liability).

Facts

In February 2009, Petitioner Francis V. Lorenzo ("Lorenzo") became the director of investment banking at Charles Vista, LLC ("Charles Vista"). (Pet. App. 3). Petitioner has never had a securities violation in his 28 year career. (Lorenzo Hearing Testimony, Joint Appendix ("JA") 312) Charles Vista was a broker-dealer registered with the SEC and owned by Gregg Lorenzo. (Pet. App. 3.) One of Charles Vista's clients was Waste2Energy Holdings, Inc. ("W2E"). W2E represented to Charles Vista and to the public that it had developed a valuable "gasification" technology that could generate electricity by converting solid waste into gas. (*Ibid.*) W2E was a public company with various SEC filings publicly available that described its operations and financial condition in detail. (Pet. App 4).

In September 2009, W2E conducted a private offering of $15 million in convertible debentures to select investors. (Pet. App. 3). Debentures are "debt secured only by the debtor's earning power, not by a lien on any specific asset." BLACK'S LAW DICTIONARY 486 (10th ed. 2014). Charles Vista

served as the exclusive placement agent for W2E's debenture offering. (Pet. App. 3-4).

In its most recent SEC filing at the time, the June 3, 2009 Form 8-K (which is used to notify investors of certain specified material events), W2E stated that its intangible assets, including its gasification technology, were worth just over $10 million as of the end of 2008. (Pet. App. 4). On September 9, 2009, W2E prepared a private offering memorandum for potential investors that described the offering, the debentures and W2E's financial condition. (*Ibid.*)

W2E's gasification technology never materialized and on October 1, 2009, after a lengthy audit, W2E filed an amended Form 8-K, in which it reported a total "impairment" of its intangible assets, because management made a determination that the company's assets were of no value. (Pet. App. 3-4). W2E reduced the value of its gasification technology to zero and its total assets to $370,552 as of March 31, 2009. (Pet. App. 4). On the same day that it filed its amended Form 8-K, October 1, 2009, W2E also filed a quarterly Form 10-Q with the SEC, in which it valued its total assets at $660,408 as of June 30, 2009. (*Ibid.*)

Later on October 1, 2009, Lorenzo's secretary alerted him by email that W2E had filed an amended Form 8-K. (Pet. App. 4). The next day, Lorenzo emailed links to both of W2E's October 1 filings to all Charles Vista brokers. (*Ibid.*) There is no evidence that Lorenzo read the two SEC filings in detail or that he was aware that W2E had written down the value of its assets.

On October 14, 2009, Lorenzo sent two emails within seconds of each other to two potential investors containing "several key points" about W2E's pending debenture offering. (Pet. App. 5, JA 403-06). His emails were copy and pasted from his boss. (JA 244). Lorenzo testified that he sent the emails without thinking about the contents. (Pet. App. 38, 61 and 109). Petitioner did not know or interact with the two recipients of the email. (JA 174-75; 317-19). In fact, one of the two potential investors testified that the Petitioner's email went to his spam account. (JA 172-73). Petitioner never followed up with either individual because the two individuals were not his clients as they were clients of other Registered Representatives of the firm. (JA 322). His emails omitted any mention of the devaluation of W2E's intangible assets. Lorenzo's emails stated to both recipients that the offering came with "3 layers of protection: (I) [W2E] has over $10 mm in confirmed assets; (II) [W2E] has purchase orders and LOI's for over $43 mm in orders; (III) Charles Vista has agreed to raise additional monies to repay these Debenture holders (if necessary)." (Pet. App. 5, JA 403-06) One of Lorenzo's messages said that it had been sent "[a]t the request of Gregg Lorenzo," and the other stated that it had been sent "[a]t the request of Adam Spero [a broker with Charles Vista] and Gregg Lorenzo." In both messages, Lorenzo stated that the recipients could call him with any questions. He signed both messages with his name and title as "Vice President – Investment Banking." (*Ibid.*) Neither recipient of Petitioner's emails invested as a result of Petitioner's email. (JA 175; 317-19)

3. On February 15, 2013, the SEC commenced enforcement proceedings against Petitioner, Gregg

Lorenzo, and Charles Vista by issuing an Order Instituting Proceedings ("OIP"). (Pet. App. 5; OIP at JA 15-39). The OIP, which started the proceedings and is the administrative equivalent of a complaint, did not distinguish between the various subsections of the antifraud provisions of the securities laws and merely charged each respondent with violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Gregg Lorenzo and Charles Vista settled the charges against them. Under the terms of the settlement Gregg Lorenzo was permanently barred from the securities industry and he and Charles Vista were jointly ordered to pay disgorgement of $130,000 and prejudgment interest of $20,000. In addition, Gregg Lorenzo was ordered to pay a civil penalty of $375,000 and Charles Vista was ordered to pay a civil penalty of $4,350,000. See the Commission's Order *In the Matter of Gregg Lorenzo et al.*, SEC Release No. 33-9480, 2013 WL 6087352 (Nov. 20, 2013).

Petitioner did not settle with the SEC and the claims against him concerning the two emails proceeded to an administrative hearing before an SEC administrative law judge. (Pet. App. 5-6). On September 18 and 19, 2013, an administrative hearing was held before the administrative law judge, and, on December 31, 2013, an Initial Decision was rendered (Pet. App. 98-121). After hearing Petitioner's testimony and weighing his credibility, the judge concluded that Petitioner's boss (Gregg Lorenzo) had "drafted" the emails in question (Pet. App. 106) and that Petitioner's boss had "asked" Petitioner to send the emails to the two clients. (Pet. App. 38; 106). The

administrative law judge also concluded that Petitioner did not read the text of the emails and that Petitioner "sent the emails without even thinking about the contents." (Pet. App. 38; 109). Furthermore, the judge noted that the emails themselves expressly stated that they were being sent at "the request" of Petitioner's boss. (Pet. App. 39; 107). "Those factual findings were very favorable to [Francis] Lorenzo and should have cleared Lorenzo of any serious wrongdoing under the securities laws." (Kavanaugh, J., dissenting) (Pet. App. 39).

"Nevertheless, [t]he judge somehow concluded that those findings of fact demonstrated that Lorenzo willfully violated the securities laws – meaning that Lorenzo acted with an intent to deceive, manipulate, or defraud." (Kavanaugh, J dissenting) (Pet. App. 39). The administrative law judge's decision, like the OIP, did not distinguish between any of the subsections of the antifraud provisions and merely concluded that Petitioner violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

As a sanction, the judge: (i) ordered Lorenzo to cease and desist from violating each securities-fraud provision giving rise to the charges against him; (ii) imposed against Lorenzo a lifetime bar from the securities industry; and (iii) imposed a civil monetary penalty of $15,000. (Pet. App 39; 119; 120).

> However, the administrative law judge's factual findings and legal conclusions do not square up. If Lorenzo did not draft the emails, did not think about the contents of the emails, and sent the emails only at the behest of his boss, it is impossible to find that Lorenzo acted 'willfully'.

> That is Men's Rea 101. Establishing that a defendant acted willfully in this context requires proof at least of the defendant's 'intent to deceive, manipulate, or defraud.' *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008) (internal quotation marks omitted)." (Kavanaugh, J., dissenting) (Pet. App. 39).

4. Lorenzo petitioned the Commission for review of the Initial Decision and argued that the administrative law judge's factual findings did not support the judge's legal conclusions and sanctions. The Commission came to the same conclusion. "But instead of vacating the order against Lorenzo, the Commission did something quite different and quite remarkable. In a Houdini-like move, the Commission rewrote the administrative law judge's factual findings to make those factual findings correspond to the legal conclusion that Lorenzo was guilty and deserving of a lifetime suspension." (Kavanaugh, J., dissenting) (Pet. App. 41).

> Without hearing from Lorenzo or any other witnesses, the Commission simply swept the judge's factual and credibility findings under the rug. The Commission concluded that Lorenzo himself was 'responsible' for the emails' contents. . . Faced with inconvenient factual findings that would make it hard to uphold the sanctions against Lorenzo, the Commission – without hearing any testimony – simply manufactured a new assessment of Lorenzo's credibility and rewrote the judge's factual findings. (Kavanaugh, J., dissenting) (Pet. App. 41-42).

On April 29, 2015, the Commission issued an Opinion sustaining the Initial Decision's conclusion. The Commission's opinion did distinguish between the various subsections of the antifraud provisions and held that the two emails in question violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5(a), (b) and (c) thereunder (Pet. App. 62-77). The Commission Opinion made no findings with regards to Section 17(a)(2) or (3) The Commission Opinion imposed on Lorenzo a cease-and-desist order, a lifetime bar from the securities industry and a civil monetary penalty of $15,000. (Pet. App. 51-97). The Commission denied Lorenzo's motion for reconsideration on June 3, 2015. (Pet. App. 6). The appeal to the D.C. Circuit followed.

5. On September 15, 2017, the D.C. Circuit overturned the Commission's finding that Lorenzo violated Rule 10b-5(b) on the grounds that under *Janus* Lorenzo did not make the misstatements at issue and vacated the Commission's sanctions. (Pet. App. 1-37). However, the D.C. Circuit in a 2-1 decision upheld the Commission's findings that Lorenzo violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Securities Exchange Act, and Rule 10b-5(a) and (c). (Pet. App. 25). Judge Kavanaugh issued a dissenting opinion that sharply disagreed with the majority's holding that Lorenzo violated any of those securities fraud provisions. In particular, Judge Kavanaugh criticized the majority's deference to the Commission's finding that Lorenzo acted with scienter. "How could Lorenzo have intentionally deceived the clients when he did not draft the emails, did not think about the contents of the emails, and sent the emails only at his boss's direction?" (Kavanaugh, J., dissenting) (Pet.

App. 39-40) Judge Kavanaugh in his dissent also noted that the majority decision is inconsistent when it holds on one hand that Petitioner transmitted statements written by his boss and at his boss's direction and on the other hand also holds that Petitioner engaged in a scheme to defraud solely because of the statements made by Petitioner's boss. (Pet. App. 48)

Judge Kavanaugh was also highly critical of the majority's deference to the Commission's rewriting of the administrative law judge's factual findings. Judge Kavanaugh stated

> Lorenzo was the only relevant witness at trial . . . and given that his credibility was central to the case, the SEC had no reasonable basis to run roughshod over the administrative law judge's findings of fact and credibility assessments. In short, the SEC's rewriting of the findings of fact deserves judicial repudiation, not judicial deference or respect. (Kavanaugh, J., dissenting)(Pet. App. 45)

In fact, Judge Kavanaugh severely criticized the Commission's entire administrative process in the way it handled the enforcement proceedings against Lorenzo. "The administrative law judge's decision in this case contravenes basic due process (Pet. App. 40). . . Lorenzo is entitled to a fair process just like everyone else. He has not received a fair process in this case." (Kavanaugh, J., dissenting)(Pet. App. 40, 49)(citations omitted)

The D.C. Circuit remanded the case to the Commission for reconsideration of the appropriate penalties to impose on Petitioner. "Because we cannot

be certain what role, if any, the Commission's misperception that Lorenzo was the "maker" of the false statements ultimately played in its choice of sanctions, we must remand to enable it to reassess the appropriate penalties." (Internal citations and quotations omitted)(Pet. App. 35-36). The Petition for a Writ of Certiorari was filed on January 26, 2018. This Court granted the petition for a Writ of Certiorari on June 18, 2018. The Commission has not yet issued a decision regarding the sanctions it will impose on Petitioner pursuant to the remand from the D.C. Circuit.

SUMMARY OF ARGUMENT

The D.C. Circuit majority incorrectly held that Petitioner violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c)

1. In *Janus* this Court held that only defendants who make a misstatement may be held primarily liable for violations of Section 10(b) and Rule 10b-5(b). The D.C. Circuit's opinion allows the SEC to sidestep the standards that this Court set for misstatement claims in *Janus*. Under the D.C. Circuit's decision the SEC may bring inadequate fraudulent statement claims merely by relabeling them as fraudulent scheme claims. This result renders *Janus's* standards for misstatement claims meaningless. (*See Kelly*, 817 F. Supp. 2d at 344)("Where the primary purpose and effect of a purported scheme is to make a public misrepresentation or omission, courts have routinely rejected the SEC's attempt to bypass the elements necessary to impose 'misstatement' liability under subsection (b) by labeling the alleged misconduct a 'scheme' rather than a 'misstatement.'")

2. The D.C. Circuit's decision also takes an overly broad view of primary liability and virtually eliminates the distinction between primary and secondary liability under the securities laws. To allow the SEC to use a fraudulent scheme theory to pursue primary liability against a defendant who did not make a misstatement would erase the distinction between primary and secondary liability. This, in turn, would allow the SEC to pursue primary liability against defendants that are really secondary actors at best. In the context of private securities litigation the D.C. Circuit's decision would allow private plaintiffs to bring claims against defendants that would otherwise be barred as aiding and abetting claims. *See Global Crossing Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 337 n.17 (S.D.N.Y. 2004) (Subsections (a) and (c) may only be used to state a claim . . . for the underlying deceptive devices or frauds themselves, and not as a short cut to circumvent *Central Bank*'s limitations on liability for a secondary actor's involvement in making misleading statements. (*quoting In re Lernout & Hauspie Sec. Litig.*, 230 F. Supp. 2d 152, 175 (D. Mass. 2002))). Here, the SEC's interpretation of Rule 10b-5(a) and (c) and each subsection of Section 17(a) blurs the difference between a person with primary liability and an aider and abettor. The SEC's interpretation is also inconsistent with *Janus* because *Janus* intended to "draw a clean line between" those who are primarily liable and those who are secondarily liable. *Janus*, 564 U.S. at 143 n.6 (2011). The theory of "scheme" liability advanced by the SEC is virtually indistinguishable from aiding-and-abetting liability, which is not alleged by the SEC in this matter. The D.C. Circuit decision would allow the SEC and private plaintiffs to relabel conduct that was previously deemed aiding and abetting as

"primary" participation in a fraudulent "scheme." The SEC's scheme theory of liability would also effectively render *Central Bank* a nullity. Under the SEC's reasoning there is no distinction between the Petitioner's ministerial acts and "giving aid to a person who commits a manipulative or deceptive act", the precise conduct held to be outside the scope of Section 10(b) in *Central Bank*, 511 U.S. at 177. Thus, the exact conduct that was previously denominated as aiding and abetting – providing "substantial assistance", with scienter, to a primary violator – could in essentially every case be relabeled through artful pleading as participation in a scheme to defraud. For all practical purposes, *Janus* and *Central Bank* would be invalidated by pulling defendants who are at best aiders and abettors into primary liability. This type of broad primary liability was exactly what the Court rejected in *Janus*. "First Derivative's rule would create the broad liability that we rejected in *Stoneridge*." (*Janus*, 564 U.S. at 146)

3. The D.C. Circuit's decision is not consistent with the text of the antifraud provisions because Lorenzo did not engage in any inherently deceptive or manipulative conduct by sending the emails drafted by his boss. "The language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception." *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 473 (1977). Here, there is no allegation that Petitioner engaged in manipulative trading practices. In addition, Petitioner did not "use" or "employ" a deceptive or fraudulent scheme because he only copied and pasted language drafted by his boss and such conduct is outside of the active conduct implied by the words "using" or "employing" a deceptive

or fraudulent scheme. The panel majority did not find that Petitioner engaged in any conduct that itself was deceptive or manipulative.

A primary principle that has defined this Court's jurisprudence under Section 10(b) is that in determining "the scope of conduct prohibited by § 10(b), the text of the statute controls." *Central Bank*, 511 U.S. at 173, 177. "It is inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text." *Id.* at 177. This Court's precedents have established three principles regarding the scope of Section 10(b). First, the plain language of the statute prohibits only "manipulative or deceptive" acts, and private plaintiffs may not bring actions under Rule 10b-5 for conduct not prohibited by the statute. Second, the term "manipulative" is a term of art referring to trading practices that artificially inflate the price of a security. Third, "deceptive" conduct, within the meaning of Section 10(b), requires deception - namely, a misstatement or failure to disclose by one who has a duty to disclose. That is why this Court held unequivocally in *Central Bank* that "the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act." *Central Bank*, 511 U.S. at 177.

This Court has made clear that Rule 10b-5 does not go beyond the parameters of Section 10(b). *See Central Bank*, 511 U.S. at 173 (a "plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of §10(b)"); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200 and 214 (1976)(the "scope [of Rule 10b-5] cannot exceed the power granted the Commission by

Congress under § 10(b)"). Because Petitioner did not engage in manipulative or deceptive conduct -- and did not make the misstatements at issue -- his conduct does not satisfy the requirements for Section 10(b) liability and Rule 10b-5(a) and (c)'s scheme language cannot provide a basis for liability here. Likewise, the lack of any deceptive conduct by Petitioner precludes liability under Section 17(a)(1), which similarly talks of employing devices, schemes and artifices to defraud.

4. Overturning the D.C. Circuit's decision that Petitioner was a primary violator of Section 10(b), Rules 10b-5(a) and (c) and Section 17(a)(1) would not harm the SEC's enforcement program because Congress has provided the SEC with other effective remedies for the conduct at issue. Petitioner's transmission of the two emails that his boss Gregg Lorenzo wrote makes Petitioner a secondary actor at best in this case. Section 20(e) of the Exchange Act is entitled "Prosecution of persons who aid and abet violations" and authorizes the Commission to bring aiding and abetting charges against secondary actors. Section 20(e) authorizes the SEC, but not private plaintiffs, to bring an action against secondary actors who knowingly provide substantial assistance to a primary violator of the securities laws. Section 20(e) was passed by Congress in 1995 as part of the Private Securities Litigation Reform Act, Pub. L. 104-69, 109 Stat. 737 (Dec. 22, 1995) ("PSLRA") and in response to *Central Bank*'s elimination of aiding and abetting liability in private actions under Section 10(b).

In addition to the general authority the Commission has to bring aiding and abetting cases under Section 20(e) other provisions of the Exchange Act expressly

authorize the SEC to bring enforcement cases against associated persons of broker-dealers such as Petitioner. Sections 15(b)(4)(E) and 15(b)(6) of the Exchange Act grants the SEC express statutory authority to file civil enforcement actions against registered broker-dealers and their associated persons who "willfully aided, abetted, counseled, commanded, induced, or procured" violations of the securities laws. 15 U.S.C. §§ 78o(b)(4)(E) and 78o(b)(6)(A). Under these provisions the SEC may suspend for up to twelve months or permanently bar any person associated with a broker or dealer who "has willfully aided, [and] abetted" any violation of the securities laws. 15 U.S.C. §§ 78o(b)(6)(A), 78o(b)(4)(E). Under Section 21B of the Exchange Act, the SEC may also impose monetary penalties against persons who have "willfully aided, [and] abetted" another's violation of the securities laws. 15 U.S.C. § 78u–2(a)(2). However, these aiding and abetting statutes are not at issue in this proceeding because the SEC chose to pursue Petitioner as a primary violator and not as an aider and abettor.

ARGUMENT

I. The D.C. Circuit Majority Decision Renders *Janus's* Standards for Misstatement Liability Meaningless

A. The Statutory and Regulatory Text

"'[T]he starting point in every case involving construction of a statute is the language itself.'" *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976)(*quoting Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975)). The Court has specifically emphasized

"[a]dherence to the text in defining the conduct covered by § 10(b)." *Central Bank*, 511 U.S. at 174.

The statutory and regulatory framework of the antifraud provision of the federal securities laws prohibit two classes of misconduct in connection with the purchase and sale of securities – fraudulent misstatements and omissions on one hand and fraudulent schemes and conduct on the other. Fraudulent misstatements and omissions are proscribed by Section 10(b), Rule 10(b)-5(b), and Section 17(a)(2). Fraudulent conduct is proscribed by Section 10(b), Rules 10b-5(a) and (c) and Sections 17(a)(1) and (3).

Specifically, Section 10(b) makes it "unlawful for any person directly or indirectly . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of" Commission rules. Rule 10b-5 implements the Commission's authority under Section 10(b) through three subsections.

Rule 10b-5(b) makes it unlawful for "any person to make any untrue statement of material fact..." Subsections (a) and (c) of Rule 10b–5 pertain to what courts have termed "scheme liability." Subsections (a) and (c) make it "unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, [c. ... (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." Section 17(a)(1) similarly makes it unlawful

for "any person...to employ any device, scheme or artifice to defraud."

Liability under Rule 10b-5 cannot extend beyond conduct included in Section 10(b)'s prohibitions. Section 10(b)'s prohibition encompasses only acts that are "themselves manipulative or deceptive." Accordingly, only conduct that is itself manipulative or deceptive violates Rule 10b-5. *See Flannery*, 2014 WL 7145625, at *12; *see also In the Matter of Robert W. Armstrong, III*, Exchange Act Release No. 51920, 2005 WL 1498425, at *6 (June 24, 2005); *In the Matter of Leslie A. Arouh*, Exchange Act Release No. 50889, 2004 WL 2964652, at *5 (Dec. 20, 2004).

Courts have described Section 17(a)'s proscriptions as "substantially identical" to those in Rule 10b-5. *See, e.g., Landry v. All Am. Assurance Co.*, 688 F.2d 381, 386 (5th Cir. 1982); *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999) ("Essentially the same elements are required under Section 17(a)(1)-(3) in connection with the offer or sale of a security" as under Rule 10b-5, "though no showing of scienter is required . . . under [Section 17](a)(2) or (a)(3)."); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996) ("With respect to § 17(a)(1), essentially the same elements [as in a Rule 10b–5 claim] must be established in connection with the offer or sale of a security."). Other cases also equate the elements of a Rule 10b-5 violation and a Section 17(a) violation. The exceptions are that negligence is sufficient for a violation of Section 17(a)(2) and (3) and that Section 17(a) applies in the offer or sale of a security rather than in connection with a purchase or sale. *See SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 285 (2d

Cir. 2013) ("The requirements for a violation of Section 17(a) apply only to a sale of securities but in other respects are the same as Section 10(b) and Rule 10b-5, except" for the different mental state requirements); *SEC v. Morgan Keegan & Co.*, 678 F.3d 1233, 1244 (11th Cir. 2012); *SEC v. Washington Cnty. Util. Dist.*, 676 F.2d 218, 225 (6th Cir. 1982) ("[I]t is axiomatic that, with regard to conduct affecting the sale of securities, Rule 10b-5(2) and Sec. 17(a)(2) are coterminous, except to the degree that proof of scienter is required by Rule 10b-5(2)."). *See also Flannery*, 2014 WL 7145625, at *15 n.79.

B. The *Janus* Court Held Only Defendants who Make Misstatements Can Be Primarily Liable Under Section 10(b) and Rule 10b-5(b)

This Court in *Janus* established a bright-line test to determine the circumstances under which a defendant can be held primarily liable for misstatements under Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder. *Janus* held that a defendant may be held primarily liable under Rule 10b-5(b) only if the defendant was the "maker" of the misstatement. *Janus*, 564 U.S. 142-43.

In *Janus*, investors in the Janus Investment Fund (the "Fund") brought suit under Section 10(b) of the Exchange Act and Rule 10b-5 against the Fund's adviser and administrator, Janus Capital Management LLC ("JCM") alleging that false statements were made in the Fund's prospectuses. JCM was alleged to have helped prepare the prospectuses at issue and disseminated them to investors through JCG's website. This Court dismissed the case against JCM on the

ground that only the Fund -- and not JCM -- "made" the allegedly improper statements.

> For purposes of Rule 10b–5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not "make" a statement in its own right. One who prepares or publishes a statement on behalf of another is not its maker. And in the ordinary case, attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed. This rule might best be exemplified by the relationship between a speechwriter and a speaker. Even when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is the speaker who takes credit—or blame—for what is ultimately said. *Janus*, 564 U.S. at 142-43 (2011)

In this case the D.C. Circuit correctly held that Petitioner did not make the misstatements at issue and that the maker was Petitioner's boss Gregg Lorenzo. "Voluminous testimony established that [Petitioner] transmitted statements devised by Gregg Lorenzo at Gregg Lorenzo's direction... [and] under the test set forth in *Janus*, Gregg Lorenzo, and not [Petitioner], was "the maker" of the false statements in the emails.")(Pet. App. 17) As a result the D.C. Circuit correctly vacated that part of the Commission decision that found Lorenzo had violated Rule 10b-5(b).

C. The D.C. Circuit Majority Erroneously Held that Lorenzo's Ministerial Acts in Forwarding An Email to Two People Provided a Basis for Fraudulent Scheme Liability

The D.C. Circuit erred when it held that even though Petitioner was not the "maker" of the statements at issue he could nonetheless still be held primarily liable for violating Section 10(b), Rules 10b-5(a) and (c) and Section 17(a)(1) because his ministerial conduct in sending the two emails seconds apart was enough, without anything more, to make Lorenzo a primary violator of these provisions. "Although Lorenzo does not qualify as the "maker" of those statements under *Janus* because he lacked ultimate authority over their content and dissemination, his own active "'role in producing and sending the emails constituted employing a deceptive 'device,' 'act,' or 'artifice to defraud' for purposes of liability under Section 10(b), Rule 10b-5(a) and (c), and Section 17(a)(1)." (Pet. App. 21) However, two emails, which the Petitioner didn't draft or read, sent seconds apart to two people Petitioner did not know cannot be defined as an "active role" in producing and sending the emails, particularly here where Petitioner made no follow up phone calls and neither person invested as a result of the emails.

According to the panel majority Petitioner's "active role" in producing and sending the two emails consisted only of: (i) "produc[ing] email messages containing false statements and [sending] them directly to potential investors expressly in his capacity as head of the Investment Banking Division" (Pet. App. 20); and

(ii) "produc[ing] email messages containing three false statements about a pending offering, [sending] the messages directly to potential investors, and encourag[ing] them to contact him personally with any questions." (*Ibid.*) Allowing such ministerial conduct to serve as the basis for claims is problematic for two reasons. First, the conduct by Petitioner the D.C. Circuit majority cites is not in itself deceptive and therefore cannot support the conclusion that Petitioner employed a deceptive device, act or artifice to defraud. Second, allowing such ministerial conduct to qualify as a deceptive device, act or artifice to defraud would render *Janus* meaningless because misstatement claims that do not meet the standards set forth in *Janus* can merely be relabeled, with nothing more, to qualify as claims for deceptive conduct under Section 17(a)(1), 10(b) and Rules 10b-5(a) and (c).

In fact, the *Janus* Court specifically rejected the notion that these types of ministerial acts that assist another in making a statement could be the grounds for liability under Rule 10b-5(b). Defendants who "contribute "substantial assistance" to the making of a statement but do not actually make it" cannot be held primarily liable under the securities laws. *Janus*, 564 U.S. at 143.

Moreover, there is nothing in the *Janus* decision to suggest that its reasoning should be restricted to just subsection (b) of Rule 10b-5. The misconduct that the SEC alleged against Lorenzo involves no more than his facilitation of the distribution of misstatements that were made by others. To allow Lorenzo's ministerial conduct to serve as the basis for scheme liability would render *Janus*'s distinction between claims for

misstatements and claims for fraudulent acts and schemes meaningless. The D.C. Circuit's holding improperly allows the SEC and private plaintiffs to sidestep the restrictions the *Janus* Court placed on misstatement claims under Rule 10b-5(b) by simply relabeling the claims as fraudulent schemes and pursuing them under Rule 10b-(a) and (c) and Section 17(a)(1). "Where the primary purpose and effect of a purported scheme is to make a public misrepresentation or omission, courts have routinely rejected the SEC's attempt to bypass the elements necessary to impose 'misstatement' liability under subsection (b) by labeling the alleged misconduct a 'scheme' rather than a 'misstatement.'" *Kelly*, 817 F. Supp. 2d at 344.

D. Mere Misstatements By Themselves Cannot Be The Basis of Fraudulent Scheme Claims Under the Federal Securities Laws

The D.C. Circuit's decision conflicts with the text and structure of the federal securities laws and regulations. In framing Section 17, Congress separately prohibited the use of "any device, scheme, or artifice to defraud," *see* § 17(a)(1), obtaining money or property "by means of any untrue statement of a material fact or any omission," *id.* § 17(a)(2), and "engag[ing] in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser," *id.* § 17(a)(3). The Commission divided the conduct prohibited by Rule 10(b)-5 into prohibitions against misstatements (contained in Rule 10b-5(b)) and prohibitions against fraudulent schemes (contained in Rule 10b-5(a) and

(c)). In doing so, both are best understood to have been prohibiting discrete actions—each subsection is understood to be performing different work. Unsurprisingly, before the decision below, courts have always treated misstatements as distinct from claims involving manipulation and fraudulent schemes. *Desai*, 573 F.3d at 940 ("We must recognize, however, that manipulative conduct has always been distinct from actionable omissions").

Under the D.C. Circuit's approach, all claims for false statements could be brought as fraudulent scheme claims, and, vice-versa, claims for nondisclosure of a defendant's fraudulent conduct become viable claims for misstatements and omissions. *Desai*, 573 F.3d at 940. This result conflicts with the well-established rule that statutes and rules should be construed so that effect is given to all their provisions, so that no part will be inoperative or superfluous, void or insignificant. *Hibbs v. Winn*, 542 U.S. 88, 101 (2004) (*quoted in Corley v. United States*, 556 U.S. 303, 314 (2009)).

In addition, there is nothing in the *Janus* decision to suggest that its holding is limited to just Rule 10b-5(b) and not the other subsections. To the contrary, the *Janus* decision did not limit its assessment of the fund adviser's potential liability under Rule 10b-5 to subpart (b) only and there are many places in the opinion where the Court equated liability for making a false statement to liability under Rule 10b-5 generally. For example, in the opinion's very first paragraph, the Court framed the discussion broadly, stating that "[t]his case requires us to determine whether Janus Capital Management LLC (JCM), a mutual fund investment adviser, can be held liable in a private

action under Securities and Exchange Commission (SEC) Rule 10b–5 for false statements included in its client mutual funds' prospectuses." The Court's holding was also broad when it said "[w]e conclude that JCM cannot be held liable because it did not make the statements in the prospectuses."

The Second, Ninth and Eighth Circuits have all held that to have a viable fraudulent scheme claim a plaintiff must prove that the defendant committed an inherently deceptive or manipulative act that is *independent* from any alleged misstatement. This prevents plaintiffs from having a backdoor into liability against defendants who did not make misstatements. *See Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005) (rejecting scheme liability where the sole basis for such claims is alleged misrepresentations or omissions); *see also PIMCO*, 341 F. Supp. 2d at 468-69 (rejecting scheme liability for market timing, because the fraud arose only from misleading disclosures). "Subsections (a) and (c) are not a backdoor into liability for those who help others make a false statement or omission in violation of subsection (b) of Rule 10b-5." *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 503 (S.D.N.Y 2005). "Because the core misconduct alleged is in fact a misstatement, it would be improper to impose primary liability . . . by designating the alleged fraud a manipulative device rather than a misstatement." *SEC v. KPMG LLP*, 412 F. Supp. 2d 349, 378 (S.D.N.Y. 2006); *SEC v. Benger*, No. 09 C 676, 2013 WL 1150587, at *5 (N.D. Ill. Mar. 21, 2013)(*Janus* cannot be skirted simply by artful pleading and rechristening a 10b-5(b) claim as a claim under 10b-5(a) and (c)). However, here Petitioner committed no other actions apart from sending the two emails, which

contained statements he did not author, and, therefore, he cannot have engaged in a scheme.

The Second Circuit was the first circuit to address whether misstatements by themselves could form the basis for claims for fraudulent schemes under Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c). In *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005), the Second Circuit held that misstatements alone could not form the basis of fraudulent scheme claims. In *Lentell*, the Second Circuit held that the plaintiffs failed to make out fraudulent scheme claims for market manipulation under Rule 10b-5(a) and (c) when the sole basis for the market manipulation claims were alleged misrepresentations or omissions made by the defendants. *See also SEC v. Kelly*, 817 F. Supp. 2d 340, 343-44 (S.D.N.Y. 2011)(dismissing the SEC's fraudulent scheme claims under Rule 10b-5(a) and (c) and 17(a)(2), because they were premised on a misrepresentation and neither defendant "made" the misstatement as *Janus* requires).

The Ninth Circuit in *Desai v. Deutsche Bank Sec., Ltd.*, 573 F.3d 931, 939 (9th Cir. 2009) has also held that mere misstatements standing alone cannot be the basis of claims for fraudulent schemes.

> We must recognize, however, that manipulative conduct has always been distinct from actionable omissions. Omissions are generally actionable under Rule 10b-5(b)... Manipulative conduct, by contrast, is actionable under Rule 10b-5(a) or (c) and includes activities designed to affect the price of a security artificially by simulating market activity that does not reflect genuine investor demand....If such nondisclosure of a

> defendant's fraud was an actionable omission, then every manipulative conduct case would become an omissions case. If that were so, then all of the Supreme Court's discussion of what constitutes manipulative activity would be redundant. We decline to read the Supreme Court's case law on manipulative conduct as a little more than an entertaining, but completely superfluous, intellectual exercise. *See Stoneridge*, 128 S.Ct. at 769 (listing the three types of §10(b) actions); *Cent. Bank*, 511 U.S. at 177, 114 S.Ct. 1439 (same)(citations omitted). (*Desai*, 573 F.3d at 939).

In a difference case, the Ninth Circuit held that, for fraudulent scheme claims to be actionable under Rule 10b-5(a) or (c), something more is required than just deceptive statements. *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039 (9th Cir. 2011). In *WPP* the Ninth Circuit held that a "defendant may only be liable as part of a fraudulent scheme based upon misrepresentations and omissions under Rules 10b–5(a) or (c) when *the scheme also encompasses conduct beyond those misrepresentations or omissions.*" (655 F.3d at 1057)(emphasis added). In the *WPP* case, the Ninth Circuit also stated that a "theory of recovery that merely repeats the allegations made in support of ... misrepresentation and omission claim" is not a valid claim under Rule 10b–5(a) or (c). 655 F.3d at 1057-58 (*citing In re Nat'l Century Fin. Enters., Inc. Inv. Litig.*, 2006 WL 469468, at *21 (S.D.Ohio Feb. 27, 2006)). Moreover, "[c]ourts have generally held that a Rule 10b–5(a) and/or (c) claim cannot be premised on the alleged misrepresentations or omissions that form the basis of a Rule 10b–5(b)

claim." (*WPP*, 655 F.3d at 1057). Therefore, here, even if Petitioner was the maker of the statements in the two emails, which he was not, the SEC could still not establish a scheme claim because the SEC's scheme claim is based on nothing more than Petitioner's transmission of the misstatements in the two emails.

The Eighth Circuit is in agreement with the Ninth and Second Circuits in holding that misstatements, standing alone, can never be sufficient to bring a fraudulent scheme claim under Rule 10b-5(a) or (c). In *Public Pension Fund Group v. KV Pharmaceutical Co.*, 679 F.3d 972 (8th Cir. 2012), the Eighth Circuit stated that "[w]e join the Second and Ninth Circuits in recognizing a scheme liability claim must be based on conduct beyond misrepresentations or omissions actionable under Rule 10b-5(b)." (679 F.3d at 987). In doing so, the Eighth Circuit recognized the important distinction between claims for misstatements and claims for deceptive schemes. "Claims brought under Rules 10b-5(a) and (c) are generally referred to as 'scheme liability' claims." 679 F.3d at 986 (citing *DVI, Inc.*, 639 F.3d 623, 643 n. 29).

In contrast to this majority rule, the Eleventh Circuit in *SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786 (11th Cir. 2015) held that "even a person ... who is not the 'maker' of an untrue statement of material fact, nonetheless could be liable as a primary violator of Rule 10b–5(a) and (c)." (783 F.3d 795-96) and that "[S]ubsection (b) was the only subsection at issue in *Janus*" (783 F.3d at 796). *See also SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014)("*Janus* only discussed what it means to 'make' a statement for purposes of Rule 10b–5(b) and did not

concern section 17(a)(1) or (3) or Rule 10b–5(a) or (c)" and that "the operative language of section 17(a) does not require a defendant to "make" a statement in order to be liable." (756 F.3d at 1334). Big Apple Consulting was an investor relations firm that provided investor and public relation services to microcap companies. *Big Apple*, 783 F.3d at 790. One of its clients was a small public company called CyberKey Solutions, Inc. CyberKey paid for Big Apple's services with shares of its stock. Over the course of several months Big Apple provided the public with false information related to a purported multimillion dollar purchase order that CyberKey had received from the Department of Homeland Security. The information about the false order artificially inflated the price of the stock and Big Apple sold hundreds of millions of CyberKey shares for proceeds of almost $8 million. *Big Apple*, 783 F.3d at 793-94.

Petitioner submits that the 11th Circuit's position is erroneous and inconsistent with this Court's precedent. In addition, the *Big Apple* case involved facts that are significantly different than the facts here including Big Apple's receipt of almost $8 million over the course of several months from widely disseminated false information. In contrast, Petitioner sent an email to two investors seconds apart and received only $150 when one of the investors later decided to invest through his broker.

II. The D.C. Circuit's Decision Erases the Distinction between Primary and Secondary Liability and Greatly Expands the Number of Defendants Who Qualify as Primary Violators

A. The D.C. Circuit's Holding is Inconsistent With this Court's Precedent in *Central Bank*, *Stoneridge* and *Janus*

The D.C. Circuit majority's holding that Petitioner can be held responsible as a primary violator of the securities laws under a fraudulent scheme theory constitutes an overly expansive view of primary liability under the securities laws and is inconsistent with this Court's holdings in *Central Bank*, *Stoneridge* and *Janus*. This Court has repeatedly rejected the broad reading of primary liability that the SEC is now pursuing.

> For decades . . .the SEC has tried to erase that distinction [between primary and secondary liability] so as to expand the scope of primary liability under the securities laws. For decades, the Supreme Court has pushed back hard against the SEC's attempts to unilaterally rewrite the law. *See Janus*, 564 U.S. 135; *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.* 552 U.S. 148 (2008); *Central Bank of Denver, NIA. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994). Still undeterred in the wake of that body of Supreme Court precedent, the SEC has continued to push the envelope and has tried to circumvent those Supreme Court decisions. *See, e.g., In the Matter*

of John P. Flannery & James D. Hopkins, Release No. 3981 (Dec. 15, 2014). This case is merely the latest example. (Kavanaugh, J., dissenting) (Pet. App. 47).

1. *Central Bank* Held that There is No Cause of Action for Aiding and Abetting under Section 10(b)

Central Bank held there was no cause of action for aiding and abetting in private lawsuits and established a clear rule limiting liability under Section 10(b) to those persons who themselves make a misstatement (or omission in the face of a duty to disclose) or engage in manipulative trading. *Central Bank*, 511 U.S. at 177 ("As in earlier cases considering conduct prohibited by Section 10(b), we again conclude that the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act."). Turning to the language of Section 10(b), the Court "reach[ed] the uncontroversial conclusion . . . that the text of the 1934 Act does not itself reach those who aid and abet a § 10(b) violation". *Id.* at 177.

In *Central Bank* a public building authority in Colorado issued $26 million in bonds and Central Bank of Denver served as the indenture trustee on the bonds. The plaintiffs alleged that the disclosure document for the bonds contained a misrepresentation about the appraisal of the land that secured the bonds. The plaintiffs further alleged that Central Bank had obtained an appraisal showing that the property values were declining and that the appraisal of the land securing the bonds was no longer accurate. The plaintiff's alleged that even though Central Bank was obligated to ensure that the building authority was in

a sound financial position the bank had delayed an independent review of the appraisal. The Court had to address the question of whether Central Bank was liable to the purchasers of the bonds on a legal theory of aiding and abetting. The Court held that Section 10(b) liability did not extend to aiders and abettors because the scope of Section 10(b) was strictly limited by the statute's text, which does not refer to aiding and abetting liability. *Central Bank*, 511 U.S. at 173. *Central Bank* thus reaffirmed that liability under section 10(b) is limited to those who *themselves* actually make a material misstatement or violate a duty to disclose, or who employ a manipulative device as that term of art has been interpreted and not those who simply aid and abet. The holding in *Central Bank* applies to SEC enforcement actions as well as to private lawsuits. *Stoneridge*, 552 U.S. at 167-68, 173 n.7 (Stevens, J., dissenting); *Flannery*, 2014 WL 7145625, at *15, n.73 (acknowledging that *Central Bank* requires the SEC to distinguish between primary and secondary liability).

The theory of "scheme" liability advanced by the SEC for primary liability is almost indistinguishable from aiding and abetting liability, which *Central Bank* rejected. The circuit courts that have addressed arguments virtually identical to the SEC's arguments have ruled that a secondary actor like Petitioner who neither makes a misstatement (or omission in the face of a duty to disclose) nor employs a manipulative device may not be held liable as primary violators under Section 10(b), even if the defendant is alleged to have participated in some manner in a scheme to defraud. *See Regents of Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 388 (5th Cir. 2007)

("'[D]eceptive' conduct involves either a misstatement or a failure to disclose by one who has a duty to disclose." (internal quotation marks omitted)). In *Central Bank*, this Court held that Section 10(b) prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act. *In re Charter Communications, Inc., Sec. Litig.*, 443 F.3d 987, 992 (8th Cir. 2006), *aff'd by Stoneridge*, 552 U.S. 148 (2008) ("[A]ny defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b) or any subpart of Rule 10b-5."); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226 (10th Cir. 1996)("[W]e conclude that in order for accountants to 'use or employ' a 'deception' actionable under the antifraud law, they must themselves make a false or misleading statement (or omission) that they know or should know will reach potential investors.").

In response to *Central Bank*'s elimination of aiding and abetting liability in 1995 Congress passed Section 20(e) of the Exchange Act as part of the PSLRA. Section 20(e) restored the SEC's ability to bring actions for aiding and abetting against anyone who "knowingly or recklessly provides substantial assistance to another person" in a violation of the federal securities laws. Section 20(e) did not restore the ability of private plaintiffs to bring aiding and abetting claims. The D.C. Circuit's ruling that Petitioner was a primary violator of the antifraud provisions represents and overly expansive view of primary liability and is inconsistent with Section 20(e)'s well-considered definition of an aider and abettor as one who substantially assists

another in committing a primary violation. The D.C. Circuit's decision converts Petitioner, who is a secondary actor at best, into a primary violator and extends primary liability well beyond the boundaries set by this Congress.

2. *Stoneridge* Rejected a Broad Theory of Primary Liability Like the One the SEC is Pursuing

This Court again rejected a broad test for primary liability in *Stoneridge*. In *Stoneridge* the plaintiffs alleged that Charter Communications, a large publicly traded cable television company, falsely inflated its revenues by entering into sham contracts with various vendors that allowed Charter Communications to record inflated revenue and postpone recognizing certain corporate expenses. The plaintiffs alleged that the vendors could be held primarily liable under Section 10(b) and Rule 10b-5(a) and (c) because the vendors themselves participated in a "scheme or artifice to defraud" and by engaging in a "course of business which operates . . . as a fraud or deceit." The Eighth Circuit held that *Central Bank* barred the plaintiffs' claims against the vendors. "Any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b) or any subpart of Rule 10b-5."

This Court affirmed and drew a sharp distinction between the person who made the misstatements (Charter Communications) and the vendors who played some role in facilitating the false statements. This

Court in *Stoneridge* held that the vendors were secondary actors whose involvement was too remote to satisfy the requirement of reliance. The *Stoneridge* Court held that holding the suppliers liable as primary actors would exceed the boundaries of primary liability that the Court set around Section 10(b). Part of the *Stoneridge* Court's reasoning was that the plaintiffs' arguments in favor of primary liability would contravene *Central Bank* and Section 20(e) by converting aiders and abettors into primary violators.

> Petitioner's theory, moreover, would put an unsupportable interpretation on Congress' specific response to *Central Bank* in § 104 of the PSLRA. Congress amended the securities laws to provide for limited coverage of aiders and abettors. Aiding and abetting liability is authorized in actions brought by the SEC but not by private parties. *See* 15 U.S.C. § 78t(e). Petitioner's view of primary liability makes any aider and abettor liable under § 10(b) if he or she committed a deceptive act in the process of providing assistance. . . . Were we to adopt this construction of § 10(b), it would revive in substance the implied cause of action against all aiders and abettors except those who committed no deceptive act in the process of facilitating the fraud; and we would undermine Congress' determination that this class of defendants should be pursued by the SEC and not by private litigants. *Stoneridge*, 552 U.S. at 162-63.

Like in *Stoneridge*, this Court too should draw a sharp distinction between the person who made the misstatements (here, Petitioner's boss) and the person

who had a secondary role in disseminating the statements by email (Petitioner) and hold that Petitioner cannot be held liable as a primary violator of the securities laws.

3. *Janus* Drew a Clean Line Between Those Who Are Primarily Liable and Those Who are Secondary Actors

In *Janus*, this Court again refused to extend the scope of actors who can qualify as primary defendants in claims for misstatements by holding that only those who "made" a misstatement can be liable for the misstatement. *Janus* expressed significant concern with a broad interpretation of who could qualify as the maker of a statement because of the need to maintain the distinction between primary and secondary liability. "A broader reading of 'make,' including persons or entities without ultimate control over the content of a statement, would substantially undermine *Central Bank*. If persons or entities without control over the content of a statement could be considered primary violators who 'made' the statement, then aiders and abettors would be almost nonexistent." *Janus*, 564 U.S. at 143. The *Janus* Court also indicated that it intended to "draw a clean line between" those who are primarily liable and those who are secondarily liable. *Janus*, 564 U.S. at 143 n.6.

The *Janus* Court invoked *Stoneridge* to reject broader tests for primary liability from both the government as amici and the plaintiffs themselves. The brief from the Department of Justice urged this standard:

> [A] person makes a false or misleading statement and thus can be liable as a primary violator of Rule 10b-5 when that person creates the statement, which occurs when the statement is written or spoken by him, or if he provides the false or misleading information that another person then puts into the statement, or if he allows the statement to be attributed to him. (Brief for the United States as Amici Curiae Supporting Respondent, Janus, 2010 WL 4339892, at *13 (emphasis, quotation marks, and citation omitted)).

Janus squarely rejected that argument. The *Janus* Court cited *Stoneridge* in rejecting the expansive standards offered by the government:

> Adopting the Government's definition of "make" would also lead to results inconsistent with our precedent. The Government's definition would permit private plaintiffs to sue a person who "provides the false or misleading information that another person then puts into the statement." . . . But in *Stoneridge*, we rejected a private Rule 10b-5 suit against companies involved in deceptive transactions, even when information about those transactions was later incorporated into false public statements. . . . We see no reason to treat participating in the drafting of a false statement differently from engaging in deceptive transactions, when each is merely an undisclosed act preceding the decision of an independent entity to make a public statement. *Janus*, 564 U.S. 144-45.

Thus, *Janus* rejected this broad theory of liability, holding that the rules proposed by the government "would create the broad liability that we rejected in *Stoneridge*." (*Janus*, 564 U.S. at 146); Andrew N. Vollmer, *SEC Revanchism and the Expansion of Primary Liability Under Section 17(a) and Rule 10b-5*, 10 Va. L. & Bus. Rev. 273 (2016).

Stoneridge and *Janus* thus establish this Court's view that primary liability under Rule 10b-5 is confined within boundaries and does not extend to all persons with some connection to false information received by an investor. The *Janus* Court's discussion of *Stoneridge* also demonstrates that the Court's reasoning in *Janus* was not limited to an interpretation of just subsection (b) of Rule 10b-5. In fact, the analysis and reasoning in *Stoneridge* applied to all of Rule 10b-5.

The Court has already expressed frustration about the SEC's persistently broad position on primarily liability. "This also is not the first time this Court has disagreed with the SEC's broad view of §10(b) or Rule 10b–5. *See, e.g., Central Bank of Denver, N. A. v. First Interstate Bank of Denver, N. A.*, 511 U.S. 164, 188–191 (1994); *Dirks v. SEC*, 463 U.S. 646, 666, n. 27 (1983); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 207 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 746, n. 10 (1975)." (*Janus*, 564 at 145, n. 8). In *Central Bank* the Court rejected the SEC's policy arguments in support of a broad 10b-5 aiding and abetting cause of action (*Central Bank*, 511 U.S. 164, 188–191) and in *Hochfelder* the Court rejected the SEC's arguments that negligence could be the basis of liability under Rule 10b-5. (*Hochfelder*, 425 U.S. 185, 207).

The holding of the D.C. Circuit majority converts every aider and abettor into a primary violator and this is not consistent with decades of this Court's precedent. If allowed to stand, the D.C. Circuit's decision would make *Central Bank, Stoneridge* and *Janus* irrelevant because every peripheral actor would be a primary violator.

The panel majority's expansive view of primarily liability also undermines Congress's well considered statutory scheme of primary and secondary liability. The D.C. Circuit majority decision allows the SEC "to evade the important statutory distinction between primary liability and secondary (aiding and abetting) liability. After all, if those who aid and abet a misstatement are themselves primary violators for engaging in a scheme to defraud, what would be the point of the distinction between primary and secondary liability?" (Kavanaugh, J., dissenting) (Pet. App. 46) Section 20(e) allows the SEC to bring actions for aiding and abetting against anyone who "knowingly or recklessly provides substantial assistance to another person" in a violation of the federal securities laws. The D.C. Circuit's expansive view of primary liability would permit the SEC to bring primary liability claims against defendants who did no more than provide substantial assistance to another person who violated the securities laws, which is the very definition of aiding and abetting.

B. The Distinction Between Primary and Secondary Liability is Important in SEC Enforcement Cases Because SEC Claims for Aiding and Abetting Have Different Elements Than Claims for Primary Violations

The distinction between primary and secondary liability is important in SEC enforcement actions such as this one because the express statutory provisions permitting the SEC to bring aiding and abetting claims have different elements than claims for primary liability under Section 10(b), Rule 10b-5(a) and (c) and Section 17(a)(1). In order for a defendant to be liable as an aider and abettor in an SEC civil enforcement action, the SEC must prove: "(1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party; (2) 'knowledge' of this violation on the part of the aider and abettor; and (3) 'substantial assistance' by the aider and abettor in the achievement of the primary violation." *SEC v. Apuzzo*, 689 F.3d 204, 206 (2nd Cir. 2012). The distinction between primary and secondary liability also matters a great deal for private securities lawsuits because private plaintiffs may not maintain aiding and abetting lawsuits. *Central Bank*, 511 U.S. at 191.

However, instead of maintaining the important limitations on secondary liability, the D.C. Circuit majority created a backdoor by which plaintiffs – both the SEC and private plaintiffs – can bring claims of primary violations of the securities laws under a scheme liability theory against large numbers of defendants who would otherwise be secondary actors in

SEC actions and immune from suit by private plaintiffs.

In Section 20(e) Congress authorized the SEC to pursue aiders and abettors – but only as aiders and abettors who provide "substantial assistance" – not as primary violators. The D.C. Circuit decision allowing the SEC to pursue Petitioner as a primary violator completely erases the distinction between primary and secondary liability that this Court has put in place *in Central Bank, Stoneridge* and *Janus*. The D.C. Circuit's decision also contravenes the lines Congress has established for primary and secondary liability in Section 20(e). In Section 20(e) Congress drew the line between an aider and abettor and a primary violator. Congress has spoken in Section 20(e) and an aider and abettor is a person who substantially assists a primary violation. Therefore, the conduct of a primary violator must be more than just merely providing substantial assistance, which at best is all Petitioner did when he sent the emails at issue at the direction of his boss.

C. The SEC Could Have Brought This Action Against Petitioner as an Aider and Abettor But Chose Not to Do So

The SEC has aggressively tried to expand the scope of primary liability under the securities laws even though it is empowered by Section 20(e) of the Exchange Act to bring civil actions against aiders and abettors of securities fraud. Allowing the SEC to repackage inadequate claims for misstatements as fraudulent scheme claims allows the SEC to be able to evade the important statutory distinction between primary liability and secondary (aiding and abetting) liability under Section 20(e) of the Exchange Act by

charging aiders and abettors with primary liability under a theory of scheme liability.

In this case the SEC could have brought an action under Section 20(e) of the Exchange Act against Lorenzo for aiding and abetting violations of the antifraud provisions by Gregg Lorenzo, who was Francis Lorenzo's boss and the maker of the misstatements in the two emails that were sent. While Lorenzo would have factual defenses to an SEC action for aiding and abetting, such a claim would not have raised any of the problematic legal questions that are the subject of this petition.

Nevertheless, the SEC chose not to bring aiding and abetting claims against Lorenzo and instead improperly pursued primary liability claims under a theory of scheme liability. By doing so the SEC chose to evade the important limitations that this Court has placed on securities fraud liability in *Janus*, *Stoneridge* and *Central Bank*. This Court should not permit the SEC to evade the carefully laid out elements of misstatement claims and statutory aiding and abetting claims.

Permitting primary scheme liability to be imposed on Lorenzo based on statements he did not make would also significantly broaden the categories of defendants who can be targeted for primary liability in both SEC actions and private actions. All of these newly at-risk defendants would be secondary players at best. "To attach to individuals who did no more than facilitate preparation of material misrepresentations or omissions actually communicated by others ... would swallow the bright-line test between primary and

secondary liability." *PIMCO*, 341 F. Supp. 2d at 467; *see also Kelly*, 817 F. Supp. 2d at 343.

III. THE DECISION BELOW CONFLICTS WITH THE TEXT OF SECTION 10(b) AND 17(a) BECAUSE LORENZO DID NOT EMPLOY A MANIPULATIVE DEVICE OR CONTRIVANCE, NOR DID HE EMPLOY A DEVICE, SCHEME, OR ARTIFICE TO DEFRAUD

In addition to undermining this Court's precedents, the decision below cannot be reconciled with the text of Section 10(b) and Section 17(a). Petitioner did not violate Section 10(b) because his conduct does not meet the definition of "deception" or "manipulation" under Section 10(b). Petitioner also did not violate Rule 10b-5 for the same reason, because Rule 10b-5 cannot impose liability beyond the scope of Section 10(b) itself. In addition, Petitioner did not violate *either* Section 10(b) *or* Section 17(a)(1) because he did not "use" or "employ" a manipulative, deceptive or fraudulent device or scheme. This statutory language refers to active misconduct going beyond mere support to another or aiding and abetting a violation.

A. This Court Has Defined the Terms "Deception" and "Manipulation" in Section 10(b), and Petitioner's Conduct Does Not Meet the Definitions

Section 10(b) make it unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . *any manipulative or deceptive device or contrivance* in contravention of such rules and regulations as the Commission may prescribe." (emphasis added). The

"statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act. . . . We cannot amend the statute to create liability for acts that are not themselves manipulative or deceptive within the meaning of the statute." *Central Bank*, 511 U.S. at 177- 78 (1994). *Central Bank* also stated that the "it is inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text." *Id.* at 175, 177. The *Central Bank* Court further stated it has "refused to allow 10b-5 challenges to conduct not prohibited by the text of the statute." *Id.* at 173.

The SEC's rule making authority under Section 10(b) is constrained by the text of the statute and Rule 10b-5 cannot extend liability beyond the statutory text.

> The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law . . . Thus, despite the broad view of the Rule advanced by the [SEC] in this case, *its scope can not exceed the power granted the [SEC] by Congress under § 10(b)." Hochfelder*, 425 U.S. at 213-14 (emphasis added).

In *Santa Fe Industries v. Green*, 430 U.S. 462 (1977) the Court squarely held that Rule 10b-5 liability cannot go beyond the text of Section 10(b) when it rejected a claim that a breach of fiduciary duty without deception or manipulation fell under Section 10(b)'s prohibitions. In that case plaintiffs were minority shareholders who brought an action to recover a higher price per share after the defendant majority shareholder forced the plaintiffs to sell their shares in a merger transaction.

The Second Circuit had allowed the plaintiffs' claim to proceed and held that a Rule 10b-5 action could be premised on "breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure". *Santa Fe,* 430 U.S. at 470. The Second Circuit specifically referenced Rule 10b-5(a) and (c) and stated

> [An] erroneous assumption is that in order to allege a claim under Rule 10b-5 there must be some showing of misrepresentation or lack of disclosure. . . . But only subdivision [b] of 10b-5 deals with nondisclosure and misrepresentation. The Rule contains two other subdivisions which state explicitly that fraud other than and in addition to a failure to disclose or truthfully represent is also actionable. . . . It must be that the failure to observe this broader scope of Rule 10b-5 led the court below to dismiss the complaint . . . lest there be any lingering doubt on this point, we now hold that in such cases, including the one now before us, no allegation or proof of misrepresentation or nondisclosure is necessary. *Green v. Santa Fe Industries, Inc.,* 533 F.2d 1283, 1286-87 (2nd Cir. 1976).

This Court reversed. The Court concluded that "[t]he language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception". *Santa Fe,* 430 U.S. at 473. The *Santa Fe* Court also held that the term manipulation "is 'virtually a term of art when used in connection with securities markets'" that "'refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead

investors by artificially affecting market activity". *Id.* at 476 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976)). Here, there has been no allegation that Petitioner engaged in manipulative conduct. In *Chiarella v. United States*, 445 U.S. 222 (1980) the Court addressed the concept of deception and the Court refused to extend the concept of "deception" beyond the basic common law categories of misrepresentation or a duty to disclose, holding that "[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak . . . premised upon a duty to disclose arising from a relationship of trust and confidence between the parties to a transaction." 445 U.S. 235, 230. The *Chiarella* Court expressly held that the need for either a misrepresentation or a duty to disclose is an essential element of liability under Rules 10b-5(a) or (c). *See* Daniel A McLaughlin, *Liability Under Rules 10b-5(a) and (c)*, 31 Del. J. Corp. Law 631, 636 (2006).

The holdings in *Santa Fe* and *Chiarella* made clear that under Rules 10b-5(a) and (c), just as under Rule 10b-5(b), liability cannot extend beyond three categories: (1) the making of a misrepresentation, (2) an omission or nondisclosure coupled with a duty to speak, and (3) the commission of a manipulative act. Here the SEC relies on the absence of any reference to the word "make" in subsections (a) and (c) of Rule 10b-5 and Section 17(a)(1). However, the essential elements of a Section 10(b) claim, namely a misrepresentation, duty to disclose or execution of a manipulative trade, are still required by Section 10(b) itself when pursuing a claim under Rule 10b-5(a) or (c).

Several district courts have also held that claims under Rules 10b-5(a) and (c) require either a material misstatement or the commission of a manipulative act. For example, in *In re Dynegy, Inc. Securities Litigation*, 339 F. Supp. 2d 804, 914-16 (S.D. Tex. 2004) the court dismissed claims against an outside bank that had engaged in transactions that the issuer misrepresented in its financial statements, concluding that

> *Central Bank* precludes liability based on allegations that a group of defendants acted together to violate the securities laws unless each defendant committed a manipulative or deceptive act in furtherance of the scheme. . . . Plaintiffs cannot invoke subsections (a) and (c) of Rule 10b-5 to circumvent *Central Bank*'s limitations on liability for a secondary actor's involvement in the preparation of false and misleading statements.

See also In re Lake States Commodities, 936 F.Supp. 1461, 1471-72 (N.D. Ill. 1996) (rejecting Rule 10b-5(a) & (c) liability in absence of misrepresentation, duty to disclose or claim of manipulation), *abrogated on other grounds*, *Damato v. Hermanson*, 153 F.3d 464 (7th Cir. 1998); *In re Rent-Way Secs. Litig.*, 209 F. Supp. 2d 493, 500, 505 (W.D. Pa. 2002) (rejecting Rule 10b-5(a) & (c) liability against auditor that "improperly reviewed and approved of" quarterly financial statements, where "misstatements are what the Plaintiffs allegedly relied upon to their detriment, and the allegations simply do not permit an inference that Plaintiffs relied upon any 'device,' 'scheme,' 'artifice,' 'act,' 'practice' or 'course of business' employed or engaged in by [the auditor] such that a Rule 10b-5 claim could be established."); *Charal*

Inv. Co. v. Rockefeller, 131 F. Supp. 2d 593, 603 (D. Del. 2001) ("Plaintiffs['] claim pursuant to Rule 10b-5(a) requires a demonstration of materiality even though it is not expressly required in the language of the rule"), *aff'd on other grounds*, 311 F.3d 198 (3d Cir. 2002). *See* collected cases at 31 Del. J. Corp. Law 631, 639 n.32.

In *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir.), *cert. denied*, 126 S. Ct. 421 (2005) the Court held that claims sounding in misrepresentation or omission are not actionable as "manipulation."

> [P]laintiffs cast their claims in terms of market manipulation, pursuant to Rule 10b-5(a) and (c). We hold that where the sole basis for such claims is alleged misrepresentations or omissions, plaintiffs have not made out a market manipulation claim under Rule 10b-5(a) and (c). *Lentell*, 396 F.3d at 177.

A similar conclusion was reached by the Seventh Circuit in *Foss v. Bear, Stearns & Co.*, 394 F.3d 540 (7th Cir. 2005). In that case the district court rejected plaintiff's claim for Rule 10b-5(a) and (c) liability against a brokerage firm whose employee opened accounts with securities he allegedly knew to be stolen from the plaintiff. On appeal, the Seventh Circuit affirmed, refusing to apply the label of "manipulation" and instead holding that the absence of a misrepresentation made, or duty to disclose owed, by the brokerage firm to the estate was fatal to the claim. "Foss wants us to call the conduct 'manipulation' rather than 'fraud,' but this is a distinction without a difference. In securities law, manipulation is a kind of fraud; deceit remains essential." *Foss v. Bear, Stearns & Co.*, 394 F.3d 540, 542 (7th Cir. 2005) (*citing*

Schreiber v. Burlington N., Inc., 472 U.S. 1 (1985) and *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476-77 (1977)). Just as courts have rejected attempts to repackage misrepresentation claims as manipulation claims, the Court should reject the SEC's argument that claims against Petitioner sounding in misrepresentation can be repackaged as fraudulent schemes.

B. The Decision Below Is Inconsistent with the Text of Sections 10(b) and 17(a)(1) Because Petitioner Did Not Engage in Active Misconduct

The D.C. Circuit majority's theory of liability also cannot be squared with the text of Section 10(b) making it unlawful "*[t]o use or employ*" a "manipulative or deceptive device or contrivance" in violation of SEC rules (emphasis added), or the text of Section 17(a)(1) regarding "*employ[ing]* . . . device[s], scheme[s], or artifice[s] to defraud." The plain language of these provisions requires active misconduct. The defendant must "use or employ" a deceptive device or "make" a false or misleading statement. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200–01, 212–13 (1976) (emphasizing that the statute's language "clearly connotes intentional misconduct"). Merely playing a supporting role does not give rise to liability.

Here, none of Petitioner's conduct can be fairly described as deceptive, fraudulent or playing more than a supportive role. Petitioner did not "use" or "employ" a deceptive or fraudulent scheme, because merely copying and pasting an email from his boss is too passive a role to qualify as "using" or "employing" a deceptive or fraudulent scheme. The panel majority

did not find that Petitioner engaged in any conduct that itself was deceptive or manipulative. Petitioner's purported "active role" in producing and sending the two emails consisted only of "produc[ing] email messages containing false statements and [sending] them directly to potential investors expressly in his capacity as head of the Investment Banking Division" (Pet. App. 20) and "produc[ing] email messages containing three false statements about a pending offering, [sending] the messages directly to potential investors, and encourag[ing] them to contact him personally with any questions." (*Id.* at 21). None of Petitioner's conduct involves him doing anything inherently deceptive or using or employing a manipulative or deceptive device or contrivance. Nor does Petitioner's conduct qualify as the making of a material misstatement, a conclusion that the D.C. Circuit properly rejected under the holding of *Janus*.

IV. OVERTURNING THE D.C. CIRCUIT'S MAJORITY DECISION WOULD NOT HARM THE SEC'S ENFORCEMENT PROGRAM

Overturning the D.C. Circuit's majority decision that Petitioner was a primary violator of Section 10(b), Rules 10b-5(a) and (c) and Section 17(a)(1) would not harm the SEC's enforcement program because Congress has provided the SEC with other remedies for the conduct at issue. Petitioner's transmission of the two emails that his boss Gregg Lorenzo wrote makes Petitioner a secondary actor at best in this case.

As discussed above, Section 20(e) of the Exchange Act authorizes the Commission to bring aiding and abetting charges against secondary actors. In addition to the general authority the Commission has under

20(e) to bring aiding and abetting cases under Section 20(e) other provisions Exchange Act expressly authorize the SEC to bring enforcement cases against associated persons of broker-dealers such as Petitioner. The Exchange Act grants the SEC express statutory authority to file civil enforcement actions against registered broker-dealers and their associated persons who "willfully aided, abetted, counseled, commanded, induced, or procured" violations of the securities laws. 15 U.S.C. §§ 78o(b)(4)(E), 78u-2(a)(2); *see also Central Bank*, 511 U.S. at 183. Under these provisions the SEC may suspend for up to twelve months or permanently bar any person associated with a broker or dealer who "has willfully aided, [and] abetted" any violation of the securities laws. 15 U.S.C. §§ 78o(b)(6)(A), 78o(b)(4)(E). Under Section 21B of the Exchange Act, the SEC may also impose monetary penalties against persons who have "willfully aided, [and] abetted" another's violation of the securities laws. 15 U.S.C. § 78u–2(a)(2). Here, the SEC has not argued that it has had any problems or concerns in pursuing aiding and abetting claims under Section 20(e).

In addition to the SEC's own enforcement powers, it also oversees non-governmental self-regulatory organizations, such as the Financial Industry Regulatory Authority ("FINRA"), which can bring disciplinary actions against securities firms and their employees who aid and abet violations of Section 10(b). FINRA currently regulates all securities firms registered with the SEC. FINRA is empowered to bring aiding and abetting enforcement actions against their member firms and associated persons under FINRA Rule 2010 - Standards of Commercial Honor and Principles of Trade. Overturning the D.C. Circuit's

decision would likewise not hinder the SEC's oversight of FINRA or FINRA's ability to pursue aiding and abetting claims in its own forum.

V. BROAD SCHEME LIABILITY FOR SECONDARY ACTORS WOULD HARM U.S. SECURITIES MARKETS AND IS UNNECESSARY TO DETER MISCONDUCT OR COMPENSATE INVESTORS

The SEC argues that scheme liability is necessary to deter fraud and protect the integrity of the capital markets. Even if that argument is correct it is not determinative. "Policy considerations cannot override" the "text and structure of the Act." *Central Bank*, 511 U.S. at 188. However, the SEC's argument is wrong because scheme liability would harm securities markets, damage the economy, and injure investors, while doing nothing to deter fraud. Insofar as "practical factors" are relevant *(Blue Chip Stamps*, 421 U.S. at 749), "the inexorable broadening" of liability would "result in more harm than good." *Id.* at 747-748. These practical considerations show, as in *Central Bank*, that any decision to expand liability to new classes of defendants should be left to Congress.

As far back as *Ernst & Ernst v. Hochfelder*, the Court rejected a broad remedial view of primary liability under the securities laws because the standard of liability created by a particular section of the Securities Act or Exchange Act must "rest primarily on the language of that section." *Hochfelder*, 425 U.S. at 200. "[G]eneralized references to the remedial purposes" of the securities laws "will not justify reading a provision more broadly than its language and the statutory scheme reasonably permit." *Aaron v. SEC*,

446 U.S. 680, 695 (1980) (*quoting and citing Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979); *SEC v. Sloan*, 436 U.S. 103, 116 (1978)) (internal quotation marks omitted).

Central Bank held that liability under § 10(b) is "'an area that demands certainty and predictability.'" 511 U.S. at 188 (*quoting Pinter v. Dahl*, 486 U.S. 622, 652 (1988)). This is because uncertainty drives up the costs of numerous legitimate transactions and eliminates some altogether. *See* 511 U.S. at 188-89. As the Fifth Circuit stated "[i]n *Central Bank*, the Court emphasized that securities fraud liability is an area of the law that demands certainty and predictability. Secondary liability brings neither; instead it gives rise to confusion about the extent of secondary actors' obligations and invites vague and conflicting standards of proof in divers courts." *Regents of Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 386 (5th Cir. 2007) (citation omitted). "Strict construction of § 10(b) *against* inputting aiding and abetting liability for secondary actors under the rubric of "deceptive acts" or "schemes" gives rise to the type of certainty that the Court sought in *Central Bank*." *Regents*, 482 F.3d at 392 (emphasis added). Allowing the D.C. Circuit's majority decision to stand in this matter would permit the exact type of uncertainty and unpredictability in the securities markets that *Central Bank* cautioned against.

CONCLUSION

For the foregoing reasons the judgment of the D.C. Circuit should be reversed.

Respectfully submitted,

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